DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 98-0213
Indiana Gross Retail Tax
For the Years 1993, 1994, 1995, and 1996

NOTICE: Under 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Purchase of Display Booths from Ohio Vendor – Use Tax.

Authority: IC 6-8.1-5-1; IC 6-8.1-5-1(b); 45 IAC 2.2-3-4.

Taxpayer argues that the audit review incorrectly assessed gross retail tax on the purchase of display booths which were purportedly shipped from an Ohio vendor to another location in Ohio.

II. Computer Software Updates – Use Tax.

Authority: IC 6-2.5-3-2(a); Sales Tax Information Bulletin #2 (May 2002); Sales Tax Information Bulletin #8 (May 2002); Sales Tax Information Bulletin #2 (August 1991); Sales Tax Information Bulletin #8 (February 1990).

Taxpayer maintains that the audit erred when the audit concluded that the purchase of computer software upgrades was subject to Indiana's gross retail tax.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer argues that the Department should exercise its authority to abate the ten-percent negligence penalty assessed at the time of the original 1997 audit.

STATEMENT OF FACTS

Taxpayer is in the banking business and has a number of banking locations within the state. In 1997, the Department of Revenue (Department) conducted an audit review of taxpayer's business records for the purpose of determining whether taxpayer had paid sales tax on taxable transactions or, in the alternative, had self-assessed use tax on those items for which sales tax had not been paid. Because of the sheer number of potential

transactions, the parties agreed to use a sampling method to determine the amount of additional use tax owed. The audit determined that taxpayer owed additional use tax. Later in 1997, taxpayer submitted a protest concerning certain of the assessments. The file was assigned for a hearing in 2004. After being contacted, taxpayer's representative indicated that the only remaining issue was the ten-percent negligence penalty and that a determination of whether or not to abate the penalty should be based upon the information contained within the original audit report and the 1997 protest letter. Subsequently, taxpayer decided that it wanted two specific, substantive issues addressed within the Letter of Findings. Therefore, this Letter of Findings addresses both the two substantive issues and the penalty assessment.

DISCUSSION

I. Purchase of Display Booths from Ohio Vendor – Use Tax.

In reviewing taxpayer's invoices, the audit took note of a 1995 invoice for the purchase of display booths. The invoice stated that taxpayer had bought these booths from an Ohio vendor and had paid Ohio sales tax. This was evidenced by the fact that sales tax had been assessed at the Ohio rate of 5.75 percent. Because this was the audit of an Indiana taxpayer, the audit determined that taxpayer should have paid Indiana sales tax; accordingly, the audit assessed additional use tax.

Taxpayer argues that these particular display booths were shipped from the Ohio vendor to an Ohio location and that because the booths were never delivered into Indiana, that taxpayer had no initial obligation to pay sales tax to Indiana or to thereafter self-assess Indiana use tax. In support of that contention, taxpayer has supplied a copy of its purchase order with the Ohio vendor indicating that "each requested shipment will have a release issued showing quantities ship to location and invoicing address." According to taxpayer, this purchase order is sufficient to establish that the 1995 invoice was for the purchase of display booths shipped from the Ohio vendor to an Ohio location.

45 IAC 2.2-3-4 states as follows:

> Tangible personal property, purchased in Indiana, or *elsewhere* in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the *Indiana state gross retail tax* has been collected at the point of purchase. (*Emphasis added*).

What 45 IAC 2.2-3-4 means is that if an Indiana buyer purchases an item from an out-of-state seller and then arranges for delivery of that item into Indiana, the Indiana buyer must self-assess use tax unless it paid Indiana sales tax to the out-of-state seller. This explains why the audit imposed use tax on the 1995 purchase of the display booths; it was evident from the face of the 1995 invoice that – although taxpayer paid Ohio sales tax to the Ohio vendor – taxpayer did not pay Indiana sales tax.

In support of its argument that the booths were shipped to an Ohio location, taxpayer has provided a copy its purchase order with that vendor. However, that particular purchase order – although with the same Ohio vendor – is from 1997. Although the purchase order is also for display booths, the base sales amount is different from that indicated on the 1995 invoice. Therefore, the 1997 purchase order is not dispositive on the question of whether the display booths purchased in 1995 were shipped to an Ohio location. If taxpayer has provided the 1997 purchase order to establish evidence of the normal commercial practices between itself and the Ohio vendor, the purchase would seem to simply establish that taxpayer periodically contracted with the Ohio vendor to purchase display booths and to ship those booths to different locations. The purchase order does nothing to establish the 1995 transaction resulted in the delivery of *these* display booths to a location outside Indiana.

IC 6-8.1-5-1 states that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b). Taxpayer has not met its burden of demonstrating that the 1995 invoice was for the purchase of items shipped by the Ohio vendor to an Ohio location. The audit was correct in concluding that the 1995 purchase of display booths was subject to Indiana's use tax. Although taxpayer may have paid Ohio sales tax on this identical 1995 transaction, taxpayer's quarrel is with the state of Ohio and not with Indiana.

FINDING

Taxpayer's protest is respectfully denied.

II. Computer Software Updates – Use Tax.

In reviewing taxpayer's invoices, the audit found that taxpayer failed to pay sales tax on "software maintenance fees." Therefore, the audit assessed use tax on those purchase. Taxpayer states that the assessment of use tax is unwarranted because the purchase was for computer "updates."

IC 6-2.5-3-2(a) provides that "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of the transaction or of the retail merchant making that transaction." The Department has determined that the purchase of computer updates constitutes a retail transaction in which the buyer acquires tangible personal property.

> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are

> taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook. Sales Tax Information Bulletin #8 (May 2002); *See also* Sales Tax Information Bulletin #8 (February 1990).

The particular updates of which taxpayer complains were obtained by virtue of a maintenance agreement. However, whether or not the updates were obtained pursuant to the terms of a maintenance agreement does not resolve the issue of whether the *updates* were subject to Indiana's gross retail tax. "Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax." Sales Tax Information Bulletin #2 (May 2002); *See also* Sales Tax Information Bulletin #2 (August 1991).

Depending upon the nature of the agreement, maintenance contracts may or may not be subject to gross retail tax. Id. However, this is not the issue raised by taxpayer. It is taxpayer's contention that computer "updates" are not subject to the tax. Taxpayer errs because the updates were simply "canned" computer software which constitutes tangible personal property pursuant to IC 6-2.5-3-2(a). Taxpayer has not met its burden of demonstrating that the computer updates were not subject to the state's gross retail tax.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Following the 1997 audit, the Department assessed the ten-percent negligence on the ground that "numerous items where sales tax was not paid or use tax were accrued were missed." In its 1997 protest letter, taxpayer asked that the penalty be abated because of "reasonable cause" and the assurance that "[p]rocedural changes have since been implemented that require consistent adherence to tax law . . . ."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Without excusing the taxpayer's initial failure to produce the required documents at the time of the 1997 audit review or the failure to appropriately self-assess use taxes on all of its 1993 through 1996 transactions, the Department concludes that taxpayer's failure to exercise "ordinary business care" does not necessitate imposition of the negligence penalty. The penalty should be abated in its entirety.

FINDING

Taxpayer's protest is sustained.

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